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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 646

UNITED STATES OF AMERICA, PETITIONER

v.

RAY F. SPEERS, TRUSTEE IN BANKRUPTCY OF THE KURTZ ROOFING COMPANY, ETC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The Referee's memorandum opinion (R. 35–41) is not officially reported. The district court rendered no opinion; its order is not reported. The opinion of the court of appeals (R. 44–49) is reported at 335 F. 2d 311.

JURISDICTION

The judgment of the court of appeals was entered on August 4, 1964 (R. 50). The petition for a writ of certiorari was filed on November 2, 1964, and was granted on January 18, 1965 (R. 51). The jurisdiction of this Court rests on Section 24c of the Bankruptcy Act, as amended (11 U.S.C. 47(c)), and 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a federal tax lien is valid in bankruptcy where the perfected lien arises before bankruptcy but where notice of the lien is not filed before the date of bankruptcy.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, the Bankruptcy Act, as amended, and the Treasury Regulations on Procedure and Administration (1954 Code) are set forth in the Appendix, *infra*.

STATEMENT

On June 3, 1960, the District Director of Internal Revenue assessed withholding taxes and interest of more than $14,000.00 against The Kurtz Roofing Company. On the same day the District Director made demand for payment, thus giving rise to a perfected tax lien against all of Kurtz's property under Section 6321 of the Internal Revenue Code of 1954 (26 U.S.C., App. *infra*). Seventeen days later, on June 20, 1960, Kurtz filed a voluntary petition in bankruptcy. Notice of the federal tax lien was not filed prior to the date of bankruptcy.[1] (R. 3–4, 12, 23–26, 29–30, 31–33.)

The trustee in bankruptcy refused to recognize the United States as a secured claimant through its per-

[1] In his Certificate on Petition for Review, the referee stated that notice of the federal tax lien was never filed (R. 32, 35). In fact, notice of lien was filed with Carl A. Speir, Recorder, Erie County, Ohio, the county in which the property subject to the liens was situated, on February 9, 1961. See Appendix C to the brief of the appellant in the court of appeals contained in the unprinted record on file with this Court.

fected lien. Instead, he treated the United States as an unsecured claimant entitled only to the fourth priority of payment under Section 64a(4) of the Bankruptcy Act, as amended (11 U.S.C. 104(a)(4), App., *infra*), for unsecured claims for taxes legally due and owing. As a result, although other secured creditors would be paid in full, the trustee proposed to pay only a pro rata dividend of 53.48 percent on the federal tax claims and on unsecured state and local tax claims (R. 8–10, 29, 45). The referee (R. 11–12, 33–41), the district court (R. 42–43), and the court of appeals (R. 44–49) sustained the position of the trustee.

ARGUMENT

PERFECTED FEDERAL TAX LIENS ARISING BEFORE BANKRUPTCY ARE VALID IN BANKRUPTCY EVEN THOUGH NOTICE OF LIEN IS NOT FILED PRIOR TO BANKRUPTCY

Introduction and Summary

Under Section 6321 of the Internal Revenue Code of 1954, an unsatisfied demand for delinquent taxes creates "a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to" the taxpayer. Such a perfected lien arose in this case against the taxpayer's property seventeen days before the voluntary petition in bankruptcy was filed by the taxpayer. The question for decision here is whether this lien remained valid after the taxpayer's voluntary bankruptcy. The court of appeals has held that the lien did not remain valid because of the government's failure to file notice of the lien prior to bankruptcy.

The court of appeals based its decision upon a joint reading of Section 6323(a) of the 1954 Code (*infra*) and Section 70c of the Bankruptcy Act (*infra*). Section 6323(a) provides that a federal tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor unless notice thereof has been filed * * *." Section 70c provides that a trustee in bankruptcy shall be deemed vested, as of the date of bankruptcy, "with all the rights, remedies, and powers" of a creditor holding a lien by legal or equitable proceedings as of the date of bankruptcy, whether or not such a creditor actually exists. The court reasoned that since Section 70c thus gives the trustee all the rights of a hypothetical judgment creditor as of the date of bankruptcy, he is to be deemed a "judgment creditor" within the meaning of Section 6323(a). As a result, the court held that if notice of a perfected federal tax lien is not filed prior to bankruptcy, the lien is necessarily invalid in bankruptcy.

We contend that the two sections should not be thus read to work an automatic invalidation of the federal lien upon bankruptcy. We submit, first, that, absent the trustee's designation as the holder of the powers of a hypothetical judgment creditor in Section 70c, a trustee in bankruptcy would clearly not be within the limited classes of persons to whom Section 6323(a) gives power to invalidate tax liens. That section, of its own force, was meant to benefit only mortgagees, pledgees, purchasers and judgment creditors "in the usual, conventional sense," who have an equitable claim to come before the prior but unrecorded federal tax

lien. The trustee clearly is not such a judgment creditor in the conventional sense and neither he nor the small class of creditors who would be benefitted by invalidation of the federal lien come within the equitable purpose of Section 6323(a).

If we are correct that, in the absence of Section 70c, the trustee would not be a "judgment creditor" under Section 6323(a), the case turns upon whether Section 70c, by giving the trustee the powers of a creditor holding a lien by judicial or equitable proceedings as of the date of bankruptcy, intended to incorporate within the powers thus conferred the power of a "judgment creditor" under Section 6323(a) to invalidate prior unrecorded federal tax liens. We submit that Section 70c cannot properly be so read. To do so would make it flatly inconsistent with a companion section of the Bankruptcy Act (Section 67b), would create wholly unwarranted windfalls to certain creditors as a result of bankruptcy and would unjustifiably place unsecured claims for State and local taxes on a par with prior secured federal tax claims. The general provisions of Section 70c, which are not focused upon the particular problem of the validity of federal tax liens, should therefore not be read as expanding the carefully restricted priorities created by Section 6323 (a). We do not doubt the power of Congress to include appropriate language in the Bankruptcy Act giving the trustee in bankruptcy a priority over prior unrecorded federal tax liens, but Congress has not done so. Congress might also explicitly add trustees in bankruptcy to the categories of persons described in Section 6323(a) as against whom the federal tax lien is invalid

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until notice thereof is filed, but again Congress has not done so.

A. THE TRUSTEE IN BANKRUPTCY IS NOT A "JUDGMENT CREDITOR" WITHIN THE MEANING OF SECTION 6323(a) OF THE INTERNAL REVENUE CODE OF 1954.

In order for a creditor to invalidate an unfiled tax lien of the United States under Section 6323(a) of the Internal Revenue Code of 1954, he must either be a "mortgagee, pledgee, purchaser or judgment creditor." This Court held in 1953 in *United States* v. *Gilbert Associates*, 345 U.S. 361, 364, that Congress used the words "judgment creditor" to refer to creditors who have obtained a court decree "in the usual, conventional sense of a judgment of a court of record * * *." See also *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47, 52 (Jackson, J., concurring).[2] This judicial definition was adopted in the Treasury Regulations on Procedure and Administration (1954 Code) Section 301.6323–1(a)(2)(i)(b) and (ii) (Appendix, *infra*):

> The term "judgment creditor" means a person who has obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money * * *.

[2] Likewise, this Court has held that a "purchaser" is "one who acquires title for a valuable consideration in the manner of vendor or vendee". *United States* v. *Scovil*, 348 U.S. 218, 221. Accord, *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing 227 F. 2d 359 (C.A. 7), rehearing denied, 351 U.S. 958; *United States* v. *Acri*, 348 U.S. 211, 213–214. See also, *United States* v. *Chapman*, 281 F. 2d 862, 868–869 (C.A. 10); *United States* v. *Hawkins*, 228 F. 2d 517 (C.A. 9); *New York Terminal Warehouse Co.* v. *Bullington*, 213 F. 2d 340, 344 (C.A. 5); *National Refining Co.* v. *United States*, 160 F. 2d 951, 955 (C.A. 8). With respect to the word "mortgagee", see *United States* v. *Ball Construction Co.*, 355 U.S. 587, rehearing denied, 356 U.S. 934, reversing *per curiam* 239 F. 2d 384 (C.A. 5).

By the standard thus adopted in *Gilbert Associates* and incorporated in the Regulations, a trustee in bankruptcy is clearly not a "judgment creditor" under Section 6323(a), for he plainly does not obtain a judgment against the bankrupt in the "conventional sense." For this reason, every court of appeals which considered this question prior to the decision of the Sixth Circuit in this case held that the powers conferred upon the trustee by Section 70c of the Bankruptcy Act did not constitute him a "judgment creditor" under Section 6323(a) or its predecessors.[3] *United States* v. *England*, 226 F. 2d 205 (C.A. 9); *Brust* v. *Sturr*, 237 F. 135 (C.A. 2); *In re Fidelity Tube Corp.*, 278 F. 2d 776 (C.A. 3), certiorari denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828; *Simonson* v. *Granquist*, 287 F. 2d 489 (C.A. 9), reversed on other grounds, 369 U.S. 38. See also, *In the Matter of Green*, 124 F. Supp. 481 (N.D. Ala.); *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111, 115–116 (E.D. Mich.); *In re Estrada's Market*, 222 F. Supp. 253, 256 (S.D. Calif.); *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808, 810 (C.A. 6) (dictum).

That "judgment creditor" in Section 6323(a) means judgment creditor "in the usual, conventional sense" and does not, of its own force, extend to a trustee in bankruptcy, is substantiated by the purpose of Section 6323(a) as shown by its history. Initially, there was no provision in the tax lien statute giving any subsequent creditors preference over a prior but unfiled federal tax lien. Revised Statutes, Section 3186, as amended by Section 3 of the Act of March 1, 1879, c. 125, 20

[3] The immediate predecessor to Section 6323(a) was Section 3672(a) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed. 3672(a)).

Stat. 327, 331.[4] In 1893 this Court held in *United States* v. *Snyder,* 149 U.S. 210, that a tax lien was valid even against a bona fide purchaser for value who had neither knowledge nor notice of the lien. To alleviate the hardship of this situation, Congress amended the tax lien statute in 1913 to provide that the federal tax lien should not be valid as against any "mortgagee, purchaser, or judgment creditor" until notice of the lien had been filed. Act of March 4, 1913, c. 166, 37 Stat. 1016.[5] Similar protection in the absence of filed notice was extended to a subsequent "pledgee" by Section 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, 882.

In the Committee Reports accompanying the 1913 amendment, the categories of persons intended to be protected by that amendment were referred to variously as persons "proposing to buy the property of another," "intending purchasers," "incumbrancers," or a "person who has paid full value for the property." See H. Rep. No. 1018, 62d Cong., 2d Sess.; S. Rep. No. 1315, 62d Cong., 3d Sess. See also 49 Cong. Rec. 1802. The purpose of the amendment was stated

[4] Prior to 1913 the language of Revised Statutes, Section 3186, was as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person."

[5] The pertinent language added by the 1913 amendment was as follows:

"* * * *Provided, however,* That such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated * * *."

as being to protect such a person from "los[ing] his all by reason of this secret lien," as had been possible under *Snyder*. (S. Rep., *supra*, p. 2.) The description in the House Report of the reason for the amendment additionally states (p. 1):

> A person proposing to buy the property of another could protect himself against such a lien only by ascertaining from all the collectors in the United States whether or not the vendor was delinquent in the payment of taxes. This would be a great hardship and would make it practically impossible for any person proposing to buy property to secure himself against such liens. The same hardship would devolve upon mortgagees and judgment creditors. * * *

The clear purpose of Congress in enacting the predecessor to Section 6323(a) was therefore to afford protection to certain persons who equitably were thought to have a claim superior to the government's when the government fails to file notice of its lien. In particular, protection was given to persons who, subsequent to the federal lien, take formal steps to purchase or to obtain a secured interest in a taxpayer's property in reliance upon the apparent absence of any federal lien applicable to that property. Such persons might be seriously and unconscionably harmed by a "secret" federal lien, were it later to be held valid against them. Section 6323(a) thus focuses upon the fact that the creditor actually purchased, took a mortage or a pledge, or secured a judgment in justifiable ignorance of the lien.

Plainly the trustee in bankruptcy does not actually secure a judgment against the taxpayer. Equally plainly he does not come within the protective policy

which motivated Section 6323(a). If the trustee were to cut off the federal lien, the cut-off would take place on the date of bankruptcy. Yet there is no way in which the trustee's conduct would differ if the federal lien were filed shortly before, rather than shortly after, bankruptcy, nor can the trustee conceivably take any steps before or on the date of bankruptcy detrimental to the bankrupt estate because of his ignorance of a "secret" federal lien.[5a]

Confirmation of the inapplicability of Section 6323 (a) to the trustee is contained in the legislative history of the 1954 Code. In the course of the 1954 revision of the Code, the House version of the proposed Section 6323 contained a subsection (c) which would have made it explicit that "particular persons shall not be treated as judgment creditors because State or Federal law artificially provides or concedes such persons rights or privileges of judgment creditors, or even designates them as such, when they have not actually obtained a judgment in the conventional sense." H. Rep. No. 1337, 83d Cong., 2d Sess., p. A407 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4554–4555).[6] The House Committee made clear,

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[5a] In fact, as we show in Part B(1) of our Argument *infra*, the sole effect of holding the trustee to be a "judgment creditor" who automatically invalidates unfiled federal tax liens in bankruptcy would be to create a windfall in certain creditors who would not have prevailed over the federal lien had bankruptcy not occurred.

[6] The whole of the relevant passage states as follows (p. A407):

"Subsection (c) makes it clear that the protection of subsection (a) of this section is not extended to a mortgagee, pledgee, or purchaser who takes with notice or knowledge of the existence of the Federal lien; *and that such protection is not extended to a judgment creditor who does not have a valid*

through this subsection, its intention to codify "existing court decisions * * * which determine who is a mortgagee, pledgee, purchaser, or judgment creditor by reference to the realities and the facts in a given case rather than to the technical form or terminology used to designate such person." The 1954 Senate version of Section 6323 deleted subsection (c) of the House bill, for the reason that "your committee deems

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judgment obtained in a court of record and of competent jurisdiction or to a judgment creditor who does not have a lien which has been properly perfected under such a judgment. This subsection is not designed to extend the protection of subsection (a) of this section to categories of persons now denied protection by existing court decisions (under section 357(a) of the 1939 code) which determine who is a mortgagee, pledgee, purchaser, or judgment creditor by reference to the realities and the facts in a given case rather than to the technical form or terminology used to designate such person. Paragraph (1) of subsection (c) provides that the lien shall be valid, without the filing of notice thereof, as against any mortgagee, pledgee or purchaser, if such mortgagee, pledgee, or purchaser had notice or knowledge of the existence of the lien at the time the mortgage, pledge, or purchase, was made. A dual requirement is set forth in paragraphs (2) and (3) of this subsection which a judgment creditor must meet to be entitled to the protection of the notice provisions of subsection (a) of this section. One requirement is that the judgment creditor must have actually obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money; and the other requirement is that the judgment creditor, in the case of a valid judgment for the recovery of a certain sum of money, must have a perfected lien under such judgment on the property as to which the claims of the contesting parties relate. *Furthermore, subsection (c) makes clear that particular persons shall not be treated as judgment creditors because State or Federal law artificially provides or concedes such persons rights or privileges of judgment creditors, or even designates them as such, when they have not actually obtained a judgment in the conventional sense.*" (Emphasis added.)

it advisable to continue to rely upon judicial interpretation of existing law instead of attempting to prescribe specific statutory rules." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 575 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5224). The Senate Committee further stated that "under existing law, a person who is *in fact* a mortgagee, pledgee, purchase[r], or judgment creditor will be entitled as such to the protection of this section" * * * (Emphasis added.)[1] In conference the House receded and agreed to the deletion of subsection (c) "thereby continuing in effect the existing law, including applicable rules which have been developed by judicial construction." H. Conference Rep. No. 2543, 83d Cong., 2d Sess., p. 78 (3 U.S.C. Cong. & Adm. News (1954) 5280, 5340). The language of the House Committee Report was car-

[1] S. Rep. No. 1622, *supra*, states in part, as follows (p. 575):

"This section corresponds to that of the House bill except for the deletion of subsection (c) of the House bill and conforming changes incident to such deletion.

"Subsection (c) of the House bill provided certain rules with respect to the validity of the tax lien, without the filing of notice thereof, as against mortgagees, pledgees, purchasers, or judgment creditors. The applicable rules have been developed under existing law by judicial construction, and your committee deems it advisable to continue to rely upon judicial interpretation of existing law instead of attempting to prescribe specific statutory rules. The deletion of subsection (c) will continue in effect the existing law.

"This section corresponds to section 3672 of the 1939 Code. As under existing law, a person who is in fact a mortgagee, pledgee, purchase, [sic] or judgment creditor will be entitled as such to the protection of this section irrespective of the designation applied to such person under State law, for example, in a State which has adopted the Uniform Commercial Code and which uses other terms to describe such persons."

ried over into the Treasury Regulations. See Treasury Regulations Section 301.6323–1 (Appendix, *infra*).

The final relevant effect of this episode was to continue in effect the "existing law" as to the meaning of "judgment creditor". The "existing law" regarding that term was clearly the rule referred to in the decision in *United States* v. *Gilbert Associates, supra,* decided less than one year before the date of the House Committee Report, and which articulated the precise rule which the House proposed to codify. Hence, the latest expression of the Congressional purpose embodied in Section 6323(a) shows a continued intention to restrict the preference given by that section to purchasers, mortgagees, pledgees and judgment creditors "in the usual, conventional sense" who have an equitable claim to such a preference. As we have shown, the trustee in bankruptcy does not fall within either this limited language or the limited legislative purpose.

B. THE BANKRUPTCY ACT DOES NOT INVALIDATE PRIOR UNFILED PERFECTED FEDERAL TAX LIENS

Although, as we have shown above, Section 6323(a) thus does not, of its own force, automatically invalidate prior unrecorded federal tax liens through the act of bankruptcy, that result may, of course, be achieved by other federal statutes. The court of appeals held that Section 70c of the Bankruptcy Act was such a statute. The court relied upon the fact that Section 70c vests the trustee, as of the date of bankruptcy, "with all the rights, remedies, and powers of a creditor" then holding a lien upon the bankrupt's property by legal or equitable proceedings. The court

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reasoned that Section 70c thus gives the trustee the powers of a "judgment creditor" and that since, under Section 6323(a) of the 1954 Code, one of the "rights" of a "judgment creditor" is to invalidate a prior, unfiled federal tax lien, the trustee must also be vested with that right.

The verbal logic of the court of appeals' decision is unassailable. If, indeed, the concept of a "judgment creditor" is a fixed one throughout the United States Code, then the fact that Section 70c of the Bankruptcy Act gives the trustee "all" the "rights" of a creditor holding a lien by judicial or equitable proceedings, *i.e.*, a hypothetical judgment creditor, would inevitably lead to the conclusion that the trustee has the particular power to invalidate prior federal tax liens which Section 6323(a) of the Internal Revenue Code confers upon "judgment creditors." We submit, however, that the term "judgment creditor" is not invariably used in the various statutes to connote the identical concept. Specifically, we have shown above that, whatever a judgment creditor may connote in other contexts, for the purpose of Section 6323(a), "judgment creditor" refers only to a judgment creditor "in the usual, conventional sense" of one who has actually acquired a judgment against the taxpayer without notice through filing of the federal lien, and who thus has an equitable claim to priority over the lien. The term does not mechanically apply to all persons given the designation "judgment creditor" regardless of the realities. In *United States* v. *Gilbert Associates, supra*, itself, this Court held that a person was not a "judgment creditor" for purposes of Section 6323(a) although designated as such by state law.

This case, therefore, cannot be solved through verbal identities; the powers given under the Bankruptcy Act do not automatically include the power to invalidate federal tax liens merely because similar terminology is used in the two statutes.[7a] Since Section 6323(a) does not of its own force or for its own purposes make the trustee a "judgment creditor" entitled to a priority over prior federal liens, the relevant question upon which this case must turn is whether one can fairly find that purpose in Section 70c of the Bankruptcy Act. We submit one cannot, (1) because a construction of Section 70c invalidating all unrecorded federal tax liens in bankruptcy would be flatly inconsistent with Section 67b of the Bankruptcy Act and (2) because such a construction would create a windfall and an unjustifiable priority over federal tax liens in creditors with no equitable claim whatever to such a priority. In light of these considerations, we submit that it would be unwarranted to read Section 70c, which was not specifically addressed to or focused upon the problem of priorities over federal tax liens, as expanding the carefully restricted equitable priorities created by Section 6323(a) of the Revenue Code, the statute directly addressed to that problem.

At the outset, we note that Section 70c of the Bankruptcy Act came into the law in 1910. Act of June 25, 1910, c. 412, 36 Stat. 838. This was three years before the enactment of the predecessor to Section

[7a] In actuality, the Bankruptcy Act no longer even explicitly refers to the trustee as a hypothetical "judgment creditor." That terminology, used in the original predecessor to Section 70c (Act of June 25, 1910, c. 412, 36 Stat. 838) was eliminated by Section 2 of the Act of March 18, 1950, c. 70, 64 Stat. 24.

6323(a) of the Internal Revenue Code. It is therefore clear that, at the time Section 70c was drafted and enacted, Congress did not contemplate the effect now given that Section by the court of appeals, *i.e.*, that bankruptcy would invalidate prior unrecorded federal tax liens. In 1910, such liens, once perfected, could not be invalidated by any subsequent transferees. We do not suggest that this history is, of itself, fully dispositive of the present case. A general provision like Section 70c, giving the trustee "all" the rights and powers of a hypothetical judgment creditor, is, we agree, potentially susceptible of being applied so as to enlarge the trustee's powers as the powers of a judgment creditor expand through the subsequent enactment of other statutes. We have, however, already shown that the enactment of Section 6323(a), three years after the enactment of Section 70c, cannot be deemed as reflecting a congressional policy to expand the powers of a trustee in bankruptcy. We now show that such an automatic enlargement of the effect of bankruptcy through the enactment of Section 6323(a) would also be inconsistent with the fabric and purposes of the Bankruptcy Act.

1. If Section 70c is read to invalidate all prior unrecorded federal tax liens, it is flatly inconsistent with Section 67(b) of the Bankruptcy Act

The court of appeals' reading of Section 70c is squarely inconsistent with the explicit provisions of Section 67(b) of the Bankruptcy Act (Appendix, *infra*). The court of appeals held that Section 70c invalidates all prior unrecorded federal tax liens in bankruptcy. Section 67(b), however, specifically recognizes the potential *validity* of unrecorded federal

tax liens in bankruptcy. Section 67(b) first provides that statutory liens including "statutory liens for taxes * * * owing to the United States * * * may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him." It then provides that even where such tax liens (among the other statutory liens mentioned) "are required to be perfected and arise *but are not perfected before bankruptcy, they may nevertheless be valid,* if perfected within the time permitted by and in accordance with the requirements of such laws [creating the lien] * * *." (Emphasis added.) If a tax lien is perfected after bankruptcy, it would also be recorded after bankruptcy, yet Section 67(b) provides that such a lien "may nevertheless be valid" under certain circumstances. Thus, Section 67(b) in terms clearly contemplates what the court of appeals held impossible under Section 70c: the validity of unrecorded federal tax liens in bankruptcy.[8]

[8] Regarding the meaning of Section 67(b), *4 Collier on Bankruptcy* (14 ed., 1964 Rev.), Secs. 67.20, 67.26, pp. 183, 277–278, states in part as follows (p. 183):

"By statute in many states, mechanics, materialmen, landlords, and other classes are given liens upon the rendition of their services or the furnishing of other valuable consideration. Where the lien created by law is a perfected, as distinguished from an inchoate, lien, such lien remains valid. Where, as is often the case, the lien must be perfected by compliance with certain statutory formalities, such as filing of record, new subdivision *b* permits that to be done prior or subsequent to bankruptcy, but within the time permitted by the applicable lien statute, irrespective of the debtor's insolvency or bankruptcy. Similar provision is made in favor of the sovereign where a

Sections 70c and 67b are thus not reconcilable under the court of appeals decision. They are reconcilable, however, if Section 70c is read to invalidate state *contractual* and *judicial* liens in bankruptcy, when those liens would be invalid as to a judgment creditor, but not automatically to invalidate liens created and protected by *statute,* in light of the fact that the continued potential validity of *statutory* liens but not of *contractual* or *judicial* liens) is expressly recognized by Section 67b.

The foregoing reading of the two statutes is consistent with the function of Section 70c. Its predecessor was passed in 1910 (Act of June 25, 1910, c. 412, 36 Stat. 838, 840, Sec. 8) to correct a situation in which the trustee had no better right or title to the bankrupt's property than the bankrupt had had or which the bankrupt's existing creditors actually had acquired at the time the trustee's title vested. The case which precipitated the 1910 statute, *York Manufacturing Co.* v. *Cassell,* 201 U.S. 344, 352, involved an unrecorded state contractual lien which was held valid in bankruptcy even though a judgment creditor, if one had existed, could have invalidated the lien prior to bankruptcy. See also *Security Warehousing Co.* v. *Hand,* 206 U.S. 415. In reversing the result of the *York* case, Congress wished to give the trustee power to invalidate unrecorded state non-statutory liens even if an actual judgment creditor did not exist, so long as, were a judgment creditor to exist, he could have invalidated the lien. In light of the explicit recognition

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statute gives a lien for taxes, for debts in the nature of public accounts, or for other debts owing to the United States, a State, or subdivision thereof."

See also, *New York Brooklyn Fuel Corp.* v. *Fuller,* 11 F. 2d 802 (C.A. 2).

in Section 67b of the potential validity of unperfected *statutory* liens in bankruptcy, however, there is no basis for saying that Congress similarly intended bankruptcy automatically to invalidate unrecorded statutory liens. The most reasonable assumption is that the general provisions of the Bankruptcy Act were not meant to interfere with specific statutory policies governing the circumstances under which statutory liens may be invalidated. See 4 *Collier on Bankruptcy,* note 8, *supra.* This assumption should be especially strong when bankruptcy is sought to be used to invalidate a federal tax lien in the face of a federal statute (Section 6323(a) of the Internal Revenue Code) carefully delineating the narrow classes of persons equitably entitled to supercede a prior unrecorded federal lien.

2. If Section 70c is read to invalidate all prior unrecorded federal tax liens, it creates unjustifiable priorities over such liens in creditors with no equitable claim to preferred treatment

If the trustee in bankruptcy is to be considered a "judgment creditor" for purposes of Section 6323(a), the government's unfiled tax liens would be invalid as to all creditors of the bankrupt. This construction grants no additional protection to general creditors of the bankrupt, for the federal tax claim will still be paid ahead of general creditors as a fourth priority tax claim under Section 64 of the Bankruptcy Act. (See Appendix, *infra.*) Nor does it afford added protection to the four classes of creditors protected by Section 6323(a) of the Internal Revenue Code, for their claims are secured and superior to the federal lien by virtue of that section alone. On the other hand, this construction would create an anomaly, for its result

would be that bankruptcy would automatically set aside federal liens which, absent bankruptcy, could be avoided only by the four classes of creditors protected by Section 6323(a). Bankruptcy would thus create an unexpected windfall for creditors with inchoate liens, even if acquired after the federal lien was perfected, and for other subsequent secured creditors not protected by the notice requirement of Section 6323(a), so long as State law makes those liens superior to that of a judgment creditor.

In addition, as we show above, *supra,* under Section 67b of the Bankruptcy Act, state statutory liens may be perfected under state law after bankruptcy and thus be made valid against the trustee. If a federal tax lien were to be made wholly invalid because notice of the lien had not been filed before bankruptcy, whereas an unperfected subsequent State statutory lien may be perfected after bankruptcy, the result would be to invert the order of priorities which exist absent bankruptcy, a result which cannot conceivably be justified as within the policy of Section 70c. Moreover, the construction adopted by the court of appeals permits wholly unsecured claims for State and local taxes to share equally as fourth priority tax claims with the secured tax claims of the United States, despite the special protective purposes of the federal tax lien.

Bankruptcy Act proceedings are intended to protect the assets of the bankrupt for the benefit of his general creditors. To hold that the trustee can invalidate a perfected federal tax lien because notice has not been filed does not serve any useful purpose insofar

as these intended beneficiaries of the Act are concerned for as we have shown above, even if the federal tax lien is invalidated, the tax claim must still be paid ahead of the general creditors as a Section 64a priority claim. As to other special unsecured creditors whom Congress has seen fit to favor with Section 64a priority claims (*i.e.*, administrative expenses and wage claims), this group will also not benefit from the invalidation of the federal tax lien since, under Section 67c(1) of the Bankruptcy Act, payment of the federal lien, even if the lien is valid, is subordinated to these claims in the common situation where the tax lien attaches to personal property of which the government has not secured possession prior to bankruptcy. The sum result of the court of appeals decision, therefore, would be to favor unsecured state and local tax claims and secured creditors who take their security after the federal lien arises and who do not, absent bankruptcy, meet the requirements of Section 6323(a) for invalidating the federal lien. This result cannot be justified as a matter of equity or bankruptcy policy.

In sum, the trustee in bankruptcy meets none of the requirements of a "judgment creditor" under Section 6323(a) of the Internal Revenue Code, when that section is viewed alone. The fabric of the Bankruptcy Act is similarly inconsistent with the trustee's being considered a "judgment creditor" with the result that bankruptcy would automatically invalidate prior perfected, but unrecorded, federal tax liens. In these circumstances, a joint reading of the two statutes should not lead to a different result. The general

designation of the trustee as possessor of the rights of a hypothetical judgment creditor in Section 70c of the Bankruptcy Act, should not be held to supersede the carefully enacted policy of Section 6323(a) whereby perfected federal tax liens are valid, though unrecorded, against all but four narrow classes of subsequent creditors with strong equitable claims to priority over the federal lien.[9]

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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MARCH 1965.

[9] Legislation repeatedly has been proposed in recent years explicitly to constitute the trustee in bankruptcy a "judgment creditor" with respect specifically to federal tax liens. See H.R. 7242, 86th Cong., 1st Sess., Sec. 6, which passed Congress in August 1960 (106 Cong. Record 17591), but was vetoed by the President on September 8, 1960 (106 Cong. Record 19168). The most recent bills have been H.R. 394, 88th Cong., 2d Sess., Sec. 6, and H.R. 136, 89th Cong., 1st Sess., Sec. 6. None of the bills have been enacted into law. The Committee Reports all underscore the view that only Congressional action can accomplish this result. For example, see H. Rep. No. 745, 86th Cong., 1st Sess., pp. 9–10, and S. Rep. No. 1871, 86th Cong., 2d Sess., pp. 10–11, on H.R. 7242; S. Rep. No. 1133, 88th Cong., 2d Sess., pp. 10–11, on H.R. 394.

APPENDIX

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

* * * * *

(d) *Disclosure of Amount of Outstanding Lien.*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

(26 U.S.C. 6323.)

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 64 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 874, and Sec. 19(a), Act of July 7, 1952, c. 579, 66 Stat. 426]. DEBTS WHICH HAVE PRIORITY.—

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt

by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow: *Provided, however,* That where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been re-

fused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

SEC. 67 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, and Sec. 21(c) and (d), Act of July 7, 1952, c. 579, 66 Stat. 420]. LIENS AND FRAUDULENT TRANSFERS.—* * *

* * * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the

United States or to any State or any subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court

c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee: *Provided, however,* That so much of clause (1) of this sub-

division c as restricts liens for wages and rent and clause (2) of this subdivision c shall not apply in proceedings under chapter X of this Act, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien invalid under clause (2) of this subdivision c to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee.

* * * * *

(11 U.S.C. 107.)

SEC. 70 [As amended by Sec. 23 (a) and (e), Act of July 7, 1952, *supra*]. TITLE TO PROPERTY.

a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * *

* * * * *

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date

with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

* * * * *

(11 U.S.C. 110.)

Treasury Regulations on Procedure and Administration (1954 Code):

Sec. 301.6323–1 *Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors.*

(a) *Invalidity of lien without notice*—(1) *Filing of notice.* The lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice of lien has been filed. * * *

* * * * *

(2) *Meaning of terms.* (i) As used in section 6323 and this section:

* * * * *

(b) The term "judgment creditor" means a person who has obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money and, in the case of a judgment for the recovery of a certain sum of money, who has a perfected lien under such judgment on the property involved. The term "judgment" does not include an inchoate lien, such as an attachment lien, unless and until such lien has ripened into a judgment. United States v. Security Trust and Savings Bank (1950) 340 U.S. 47. Nor does the term "judgment" include the determination of a quasi-judicial body or of an individual acting in a quasi-judicial capacity, such as, for example, the action of State taxing authorities. United States v. Gilbert Associates (1953) 345 U.S. 361; and United States v. City of New Britain (1954) 347 U.S. 81.

(ii) The determination whether a person is a mortgagee, pledgee, purchaser, or judgment creditor, entitled to the protection of section 6323(a), shall be made by reference to the realities and the facts in a given case rather than to the technical form or terminology used to designate such person. Thus, a person who is in fact and in law a mortgagee, pledgee, or purchaser will be entitled as such to the protection of section 6323(a) even though such person is otherwise designated under the law of a State, such as the Uniform Commercial Code.

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